Before you start to look for your dream home you probably want to know how much you can afford. Often homebuyers find out during the application process how much mortgage they can afford. However, if you want to determine how much mortgage you can afford, the following method is the one used by the lender to pre-qualify you for the loan amount. Pre-qualification is not an approval. The mortgage approval process involves verifying past credit, work and other historical data. Pre-qualification only determines the potential mortgage you may qualify for.

To determine "how much you can afford" you need to gather some data:

- First, you need your gross monthly income.
- Second, you need your total monthly debt payments.
- Third, you must find out the FHA qualifying rules. Usually the housing qualifying amount for most FHA mortgage is 29%. That means you should not be spending more than 29% of your income for housing.

  The other FHA qualifying ratio is your total debt ratio. This varies with the lender but we'll assume 41% of your income on debts (credit cards, insurance, car payments, etc.)
- Finally, you must settle on the term of the mortgage and the interest rate.

  There are several ways to determine the mortgage rates. One is to call the HUD Counseling Hotline at (800) 569-4287 or visit HUD online at http://www.hud.gov.

  Another place is to look in your newspaper's Real Estate section. Usually there is a half page listing of various mortgage companies advertising their rates and program types. If you examine the listing you will find programs such as 15, 20, and 30-year terms as well as FHA, balloon, fixed and ARM (adjustable rate mortgage) programs.

To simplify the mortgage calculations, assume a standard 30-year mortgage at 8% interest.

Example of gathered data:

Gross Monthly Income $3,600
Total Monthly Debt $ 612
FHA Qualifying Ratios:
Housing 29%
Total Debt 41%
Mortgage term is 30 years with an 8% interest rate

Steps to Complete the Mortgage Calculation

Step One:

Multiply the Gross Monthly Income by the Housing Ratio.

$3,600 X 29% = $1,044

Step Two:

Multiply the Gross Monthly Income by the Debt to Income Ratio.

$3,600 X 41% = $1,476

Step Three:

Add total monthly Debt Payments. These are any debt payments having six or more months remaining. Generally the lender will ignore payments less than six months. However, it is the lender's option.

Assume only a car payment of $200 per month for the next 18 months.

Step Four:

Subtract the total from Step Three ($200) from the Total in Step Two ($1,476) .

$1,476 - $200 = $1,276

Step Five:

Compare the figures in Step One ($1,044) with the figure in Step Four ($1,276) Select the lower figure and that number becomes the maximum affordable mortgage payment. So the mortgage payment becomes $1,044.

It is critical to understand that the payment amount is affected by the variable of the loan term and the interest rate. Both effect the amount a family can borrow.

The next point is deducting the required escrows for taxes and insurance. The escrows come out of the mortgage payment. So, reduce your mortgage payment by these amounts. If you have an area you are interested in buying a home, you can find out what the average yearly taxes are in houses located in the area from a real estate agent. An insurance agent can give you an average property insurance premium for the area. Divide the mortgage payment by the total of the estimated escrow amount to get a percent of the mortgage payment.

Step Six:

In the example we'll assume that 20% of your monthly mortgage payment will be for escrows. Multiply your projected mortgage payment by your estimated escrow percentage.

$1,044 x .20 = $208.80
Rounded to $209

Step Seven:

Subtract the estimated escrow amount of $209 from the estimated monthly mortgage payment of $1,044 and the amount is $835. This amount is the most mortgage (interest plus principal) the borrower can afford.

Now the challenge is to find the best mortgage for the $835 payment.

As stated earlier, we used a 30-year fixed rate mortgage at 8% interest. You may decide to plug in other terms and interest rates to see if you can afford a larger mortgage payment. The final consideration is how much can be borrowed at the best rate and term and how much risk (fixed rate versus adjustable rate) the borrower is willing to assume.

The next step is to obtain an interest rate factor to finish the calculations. These interest rate factor tables are readily found in accounting books at the library, from your lender, or through the internet.

A sample factor table follows:

Interest Rate	15 Year Mortgage	20 Year Mortgage	30 Year Mortgage
8.00%	**$9.56**	**$8.36**	**$7.34**
8.50%	**$9.85**	**$8.68**	**$7.69**

Step Eight:

Divide the mortgage payment of $835 by the mortgage factor of $7.34 which equals $113.76.

Step Nine:

Multiply the amount in Step Eight ($113.76) by $1,000 and the maximum mortgage amount becomes **$113,760**.

You should shop for a house that costs no higher than $113,760.

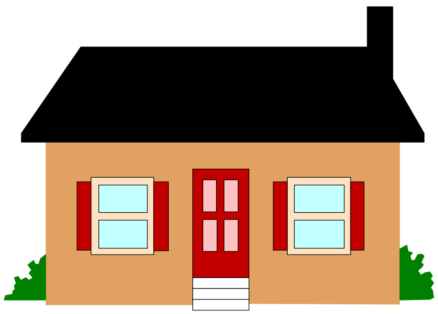
By varying the income, interest rates and term of the mortgage, the potential buyer can produce various "what if" scenarios to arrive at the best alternative.

Once you figure out what price house you can afford, you can shop for the perfect home and the perfect mortgage.

The Indiana Department of Financial Institutions, Division of Consumer Credit has many other credit related brochures available.

Call our toll-free number or write to the address on the cover for a copy of any of the brochures listed or for further consumer credit information. You can also access information at our web site on the Internet: http://www.dfi.state.in.us, then click on Consumer Credit.

HOW MUCH HOME CAN YOU AFFORD?



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